

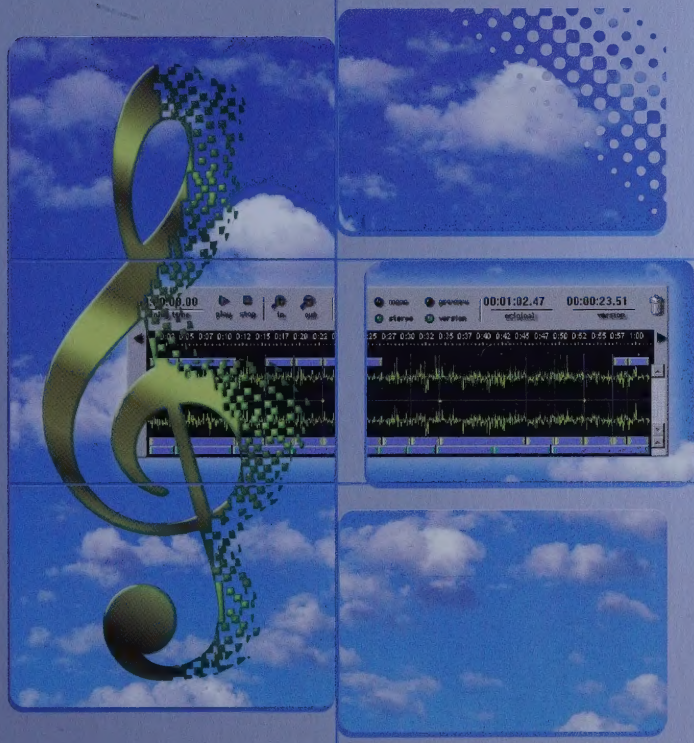
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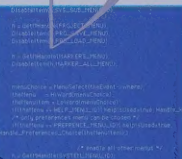
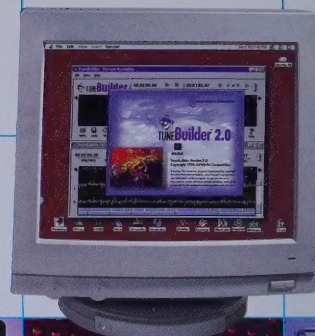
Wingear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6

AIRWORKS MEDIA INC.
1996 ANNUAL REPORT



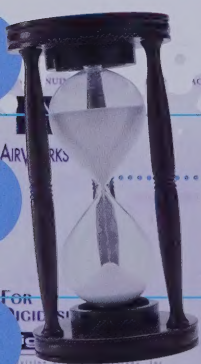
No Boundaries.

Where It's At:

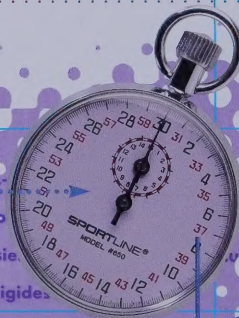


YOU OWE IT TO YOURSELF TO GO **FASTER**

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- Automatically records EDL
- Creates unique, precise, Synchron
- Checkerboards EDL for Ease
- Runs on DAE-Supported Digide



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Takes the work out of working to picture



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AUTOConform 3.0

FOR MACINTOSH

TO YOURSELF

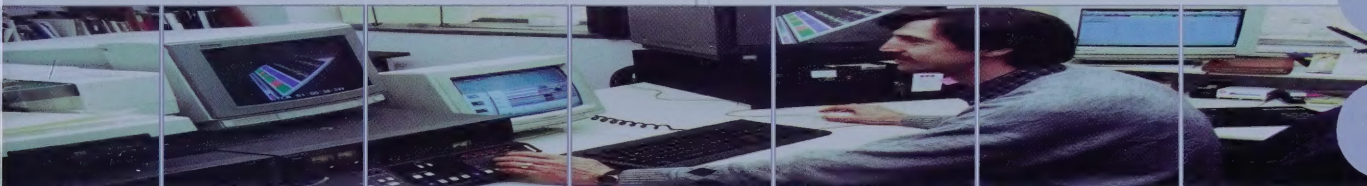
The Future of AirWorks: Automatic Sound Tools...

Wingspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6

MUSIC

forms a rich tapestry, weaving its way through our entire lives. There is music and sound all around us in movies, videos, television, radio, records, in training, education, entertainment. Every important event, every corner we turn, every memorable experience... all are accompanied by music. Yet, only the very few, experts in sound with years of training and experience, really understand how to make its power work.

Music... and sound... quite mysterious to the ordinary person. However, we all know how effective music is, and can be. Just think of the last great movie you saw. There is a very good chance that the soundtrack played a major starring role in your enjoyment and satisfaction. Try this experiment to remind yourself how powerful sound is. Sometime, right when you are enjoying your favorite television



program, video or CD, walk over to the machine and turn the sound off. What you suddenly miss is the power of sound and music. AirWorks makes music tools that make it easier, and for most people, possible, to be creative with music. Simply said, the software tools made by AirWorks make music and sound easier to use in a project. AirWorks tools help the new user explore, shape and use sound, especially music, in the new and exciting world of computers.

With the explosion at the consumer level in digital video, multimedia, and digital cameras, music is all at once thrust into prominence for the first time. People look to enhance their websites, their digital photo albums, create a business presentation... with music and sound as a major ingredient. Why? Because they are compelled by the power of music, they want to use this power in the things they are making. Helping people to harness the power of music presents a great opportunity for AirWorks, and should immediately invoke some very important questions in you, the reader... what is it that these new users of sound need to control? What are they doing where they need our tools to assist them? What are the problems solved by AirWorks' software tools that makes the user so effective as a "producer/director"?

First, one needs to be able to quickly find and listen to music and sound through vast collections. The problem with music is that it is a 'real time' experience, that is, you need to hear how the music sounds to see if it is what you may want to use. This is normally a cumbersome and time-consuming task, often leading to a "that-will-have-to-do" type of decision. Then, once you find some music that may work, you need to mock up how the music will go with your movie, family album, or presentation. This is called synchronizing, because what you are really doing is tying together two mediums... sound and pictures... to see what the experience they are creating looks and feels like when sound and image come together. Again, a difficult task.

Then, you need to be able to forge the sound and the picture together so that they always stay together when you play your presentation. You also need to store your work in presentable form, and be able to recall it easily. Then (for many of music's users), you need to be able to easily make adjustments to your work when something changes.

Making tools that control the process of sound is what AirWorks does. We understand the work flow of music and how it is used in production. We have created tools that automate everything but the creative decision, because that is the only task that most people are expert in, and indeed, is the reason they so much enjoy shaping with music and sound. The potency of AirWorks' music tools is that they automate tasks formerly done by hand by highly trained professionals with vast experience and expensive equipment taking a long time. Because AirWorks has created software that automates most of the skills needed, anyone can use music in their computers like a pro, easily, quickly and effortlessly. Now, the mystery and time-consuming impossibilities of music and sound are replaced with an easy way to

quickly make music work for you.

Up to now, AirWorks has been a research and development company, exploring new ways to harness the power of music. In the three years since the company began its quest, AirWorks has developed breakthrough technology that allows the casual user, as well the professional user, to take advantage of the power of sound.

AirWorks makes it easy to be creative using music. For the average person, this means you can make a movie in your computer and use music like a professional. Tailor music in any direction, for what you want. Add emphasis, or retrofit music to your picture, or alter music in any way.

AirWorks is in the business of helping our customers take the difficult, frustrating and impossible tasks involving music, and making them easy, fast, effortless, and very rewarding. We have taken music and sound, (something that is difficult if not impossible for the untrained or casual user to deal with), and harnessed its power. We have created intelligent and creative software systems that deliver fun, creativity and productivity. This is the compelling attraction of AirWorks software tools.

We would like to take you on a journey through the power of AirWorks software. The following is a work session on your computer, using the tools of AirWorks. On the left is the story of how you are going to progress through the session, on the right is an explanation of the AirWorks tools (both present and planned) you are using, and why they are so powerful. What you are about to read is the revolutionary future world of sound and music, now being made possible by AirWorks. Welcome to the future of music production in your computer... welcome to AirWorks...

Imagine This...

YOU ARE WORKING

on your presentation. It could be a video, a PowerPoint or multimedia presentation for a wedding, special event, movie, whatever. You have just finished the text and the pictures... now you want to make it really come alive.

You know a picture is worth a thousand words, but

MUSIC, VOICE AND SOUND TOGETHER IS A THOUSAND PICTURES.

You need to hear the sounds that naturally seem to go with what you are trying to make happen on the screen.

You need to give your presentation a voice to persuade and inspire, give it mood and imagination, shape it and lend it form. You want your presentation to speak with intensity and confidence. You need your presentation to have the power to sweep audiences away.

You need a soundtrack.

You click on the SoundHouse™ icon. Your screen jumps to life and you are suddenly in a place where you see all the tools you need — TuneBuilder®, TuneFinder™, S/Link®, SoundBuilder™, AutoBlade™, and vast libraries of music, sound effects and narrators. It is a friendly place, warm and inviting. It is a workshop that you understand

right way, even though you have never worked extensively with sound before.

It is unlike anything you have seen. You know

YOU ARE IN THE WORLD OF SOUND,

but yet you can relate to it completely, because it is all in pictures. And there in the corner is your presentation, reduced in size. You can make your presentation go to full screen any time, just by clicking the screen change button.

SoundHouse works with all standard video production, multimedia authoring tools and presentation software.

You run your presentation. It looks good, but it is silent and voiceless. Because you are now in the world of sound, your pictures suddenly seem to be distant... uninviting.

SoundHouse works with all standard video production, multimedia authoring tools and presentation software.

Users of **SoundHouse** are everyone from ordinary beginners to professional presenters, audio-visual managers, small office-home office owners, production hobbyists, and multimedia producers who wish to create soundtracks for their visual presentations.

SoundHouse is a seamlessly integrated sound task work environment for accessing, manipulating, synchronizing, control of soundfiles, and performance.

The **SoundHouse** GUI (Graphic User Interface) metaphor is accessible and easy, with most of the access to features displayed graphically.

Performance controls for the visual presentation are completely accessible from **SoundHouse**. Commands performed in **SoundHouse** are immediately synchronized with the visual presentation.



AUTOConform 3.0
TAKES THE WORK OUT OF WORKING TO PICTURE

You need music, sounds and a voice... you need a soundtrack to make it come alive to pull everything together, working in harmony to make your pictures and story

COMPELLING AND ALIVE.

You play the opening, and you realize it needs music. You click on the Sound Manager icon, and a TimeRuler opens up, the same length as your presentation. When you click on different parts of the TimeRuler, the picture in the presentation jumps to that spot. If you play, the presentation runs from that spot. If you haven't set your presentation to run a certain length, it asks you how long you want it to be. You type in the length, and the TimeRuler changes to that length. You can change it again at any time, and time will be added on the end, or inserted or removed anywhere you like. If you are working on a PowerPoint or Presentations program, you can even set the slides to change, just by selecting the slide's "timepoints" on the TimeRuler where you want it to change to the next.

You want to start with some music to open. You click on the TimeRuler at the beginning; the picture jumps to the start of the presentation. You double click on the TimeRuler; it asks you if you want to add music, voice or sound effects. You select music. A window opens up and you are in TuneFinder.

BEFORE YOU KNOW IT,

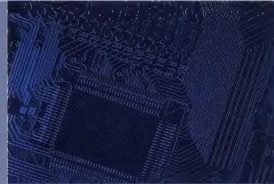
you are listening to hundreds of different pieces of music. You listen to musical ideas for what you need, just by selecting the type you want. When you tell it to play, a short sample of the selection plays. If you like, you can play the whole piece. The music is coming from a CD-ROM disk, loaded with lots of music from a whole collection of music made by professional music libraries. If there aren't enough on the disk you have, you can buy other discs with more music. You can also instantly go to SoundCentral on the Internet at any time, just by pressing the SoundCentral- Music icon. There you can listen to thousands more that you can use for a small fee.

You can listen to samples or full length versions. When you select one, pay for it and have it download immediately,

IN STUNNING PROFESSIONAL QUALITY.

You select your opening theme in just a few minutes, after listening to many great choices that TuneFinder suggests. When you make your first selection, a window

SoundBuilder is a mixer/editor environment, able to call and retrieve sound called from any location either locally or wide. In **SoundBuilder**, the sounds may be regionalized with user defined edits, and those regions manipulated. The presentation may be performed from **SoundBuilder**, and the TimeLine of the overall project is settable.



The TimeRuler is the project's TimeLine Controller.

TuneFinder is a library search and audition program, drawing its content from various libraries of production music. Auditions of the material are available to the user, either from CD-ROM, CD-Audio, or on the AirWorks Website. TuneFinder is the information interface to all media.



SoundCentral is AirWorks' centralized vending system for music and sound effects accessed on the net or in more traditional methods, such as are presently used in the production music library industry.

On the Internet, music and sound effects may be browsed, selected and the usage purchased, all in one session.

pops open, and you see your choice for the opening theme at the start of a list. This is the list of all the sound elements you will use in the presentation. It builds as you select more. If you want, you can change the order or play any selection on the list at any time.

You play your presentation, and another window opens up. This is a picture of the sound track for your presentation. It has a TimeRuler, and you see tracks running horizontally where on one, the music you have selected appears as a long block, with a label. It begins at the start of the presentation, and ends right where you told it to. You can play your presentation from here, and when you do, you see the picture change. A marker shows you where you are in the soundtrack at any time.

CLICK ON IT

and the presentation plays. You click on the beginning. Your presentation starts running with the music you have selected. A little window says "Click Again when you want the music to end." You let it play, and where you want it to stop, you click. Another window opens up and says, "How Do You Want To End?" You see different choices, "Fade," "Perfect End," "Abrupt." You pick "Perfect End." Now, when you play your presentation, it runs with the music you have selected, and it ends perfectly, right where you wanted. You have started to build your sound track.

If you double click once on the music block, it asks you if you want to change how the music progresses. Here you can change the music you have selected or the edited version. You can also change the length or type of ending at any time. If you double click on the right side of the mouse, it plays.

Now you want to put in a voice. If you have made a voice track, just drag it from the list onto the sound track window and place it on any unoccupied track. You can move a time marker from the TimeRuler just by clicking on the TimeRuler and dragging the time to the open track. You can now play the voice just by double clicking on the right mouse. You can divide up the sentences and phrases by double clicking once to open an editor.

YOU SEE A PICTURE

of the voice track, and you can play the voice track, placing markers in it where you want the sentences to start and stop. Then, play the presentation, and move the sentences under the right pictures. If you haven't gotten your script recorded, you can record right into your computer, using your own voice to tell the story. Or, if you click on the SoundCentral-Narrators icon, you can also listen to professional narrators from the world over reading samples of their voices.

Select one, e-mail your script, and then for a fee, download your finished narration track with the professional narrator reading your script.

Now when you play your presentation, it has

COME TO LIFE WITH MUSIC

The advantage to **SoundHouse** is that all workflow is integrated. The basic organization of the project is lists compiled throughout the session, depicting the status of sound and information at each stage. These lists serve the functions of traditional organizational management such as EDL's (Edit Decision Lists), usage reports, pre-selection lists, final project lists, project archiving and snapshotting, etc.

TuneBuilder is an automatic music editing program that takes its instructions from project parameters. These parameters are determined from the output created by artistic decisions (I want it to end here) or derived from a pragmatic need of an element on the timeline of the project (scene length). The user is given the ability to match length and region sequence, which is highly automated by an expert system.



TUNEBuilderTM 2.0

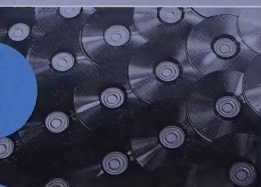
3:13" to :29" in 1 sec...


SoundBuilder allows the user to record in events such as soundfiles, or live sound from a microphone.

Once the sounds are on the TimeRuler, they may be edited and manipulated, then synchronized to the timeline of the presentation.

AutoBlade is an easy-to-understand manual editing tool, allowing the non-musician/editor to quickly divide sound into regions.

PD Cue 2.0
THE EASIEST WAY EVER TO MANAGE
AND ORGANIZE CUE SHEETS





and voice powerfully delivering your story. You can also add sound effects from your CD-ROM, or by clicking on the SoundCentral- SoundEffects icon. Listen and select sound effects and then download them to use for a small fee. If you have marked on the TimeRuler where you want

them, they are placed there automatically. If you are listening to the presentation and the music is too loud in one spot, just click on the top of the block and pull it down.

GO TO WHERE YOU WANT

it to get loud again, and shape it there too. The same with the voice and the sound effects.

If you want, you can also use MIDI music using MIDI sequences from your CD-ROM or by pressing the SoundCentral -Midi icon to go the SoundCentral

website. There you can listen to them by having the website sequence play your sound card. If you want to use them, pay a small fee and download. You can then edit them for length and instrumentation just by clicking on the MIDI block right on the TimeRuler.

Your presentation is now done, and you have put all the sound and music into it

ALL BY YOURSELF.

When you press the Save button, the presentation is automatically merged, and the sound and picture are integrated so that you can distribute it any way you like. All the sounds are in the same format, and mixed just as you wanted it. The sound can be in stereo, mono, high resolution or low, any file format. It plays under the presentation, locked into the pictures and events in the presentation. You have just made the entire presentation come to life.

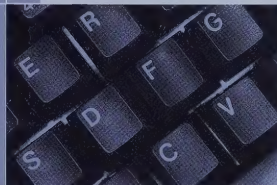
This is too easy, you say to yourself.

You have been able to do this because you have been working in a completely integrated sound world for the computer, a place where sound making tasks are integrated into one seamless workflow. All inconsistencies of formats, equipment, software and content have been eliminated. All tools are there, all source material, and all those problems that you used to have if you wanted to use sound are completely gone. All your solutions are presented before you've even seen a problem. You have had no difficulty with the work you have just completed, other than making up your mind. You have complete creative and technical freedom, and no need for highly developed skill or experience. There are no more unsolvable problems or impossible tasks, just

ANSWERS READY TO BE USED.

Making your soundtrack has been an exhilarating experience, and you feel as though you are in control. You are going to sweep them away with your story. **This is the future of sound, from AirWorks.**

SoundCentral has a service bureau for narration, scriptwriting and dramatic voicing.



Shaping sound is done in **SoundBuilder** with Dynamic Volume adjustment and other sound shaping tools.

SoundHouse is able to control and process MIDI files through **MIDIBuilder**.

SoundCentral has a MIDI file vending area

S/Link allows all sounds to automatically convert to one format, and to save in one format.

S/Link 2.1

BREAKS THROUGH THE DIGITAL
SOUND FILE TRANSFER BARRIER

SoundHouse is a broad project handling environment, covering the technical, data/information, and workflow management aspects of work tasks involving music itself, and the information about the music.

The environment consists of various programs, tools, and 'Builders' that automatically contours the configuration of the programs' screens, terminology and features.

The **SoundHouse** environment is independent of platform, storage device, transmission media and file-format. It incorporates programs to perform automatic sound editing and manipulation of soundfiles and midifiles, placement to image, location and manipulation of data information within the context of library, catalog and asset management, report generation, a system for verification of ownership, storage/retrieval, and file format issues.

Through Our Customers' Eyes

"AFTER YEARS AT THE SPLICING BLOCK THIS IS A DREAM COME TRUE. IT IS JUST WONDERFUL, IT HELPS ME EDIT IN LIGHTNING-FAST TIME."

— BIRMINGHAM CABLEVISION
(A DIVISION OF TIME WARNER)

"I'D NEVER BE WITHOUT IT AGAIN. WITH TUNEBUILDER WE ARE ABLE TO DO WHAT WE DO BEST — EDIT AND PRODUCE VIDEO — AND THE MUSIC LITERALLY TAKES CARE OF ITSELF."

— RESORT VIDEO PRODUCTIONS

"IT CERTAINLY HAS CHANGED OUR ENTIRE EDITING OUTLOOK! WE CAN NOW EDIT OUR PIECES TO ANY LENGTH, JUST BY 'WHISPERING' THE TIME LENGTH IN 'TUNEBUILDER'S EAR.' WHAT MORE COULD YOU ASK FOR?"

— SAN DIEGO COUNTY SHERIFF'S OFFICE

"IT'S A PIECE OF CAKE! I AM A NON-AUDIO TECHNICIAN WITH LIMITED MUSICAL BACKGROUND AND FIND USING THE TUNEBUILDER ALLOWS ME TO SPEND MORE TIME ON EDITING, LESS TIME ON MIXING, IT'S GREAT TO USE!"

— GRANT COUNTY
PUBLIC UTILITIES DEPARTMENT

"I CAN'T THINK OF A BETTER TOOL FOR IMPROVING A LIBRARY'S IMPLEMENTATION THAN TUNEBUILDER SOFTWARE. IT ALLOWS US TO USE THE CUT WE REALLY WANT TO USE AND IT SAVES US TIME."

— AT&T

"ENTER TUNEBUILDER...THIS IS A TOOL THAT WILL CUT YOUR MUSIC PRODUCTION TIME BY 90 PERCENT, NO MATTER HOW DIFFICULT THE MUSICAL REQUIREMENTS OR THE CLIENT. THE SOFTWARE IS INCREDIBLE."

— HALE & HEARTY PRODUCTIONS

"I PURCHASED TUNEBUILDER BECAUSE I DO NOT HAVE TIME TO WASTE."

— AUDIO ARTIST COMPANY

"THE SYSTEM IS VERY EASY TO USE. I WAS USING THE PROGRAM WITHIN 10 MINUTES!"

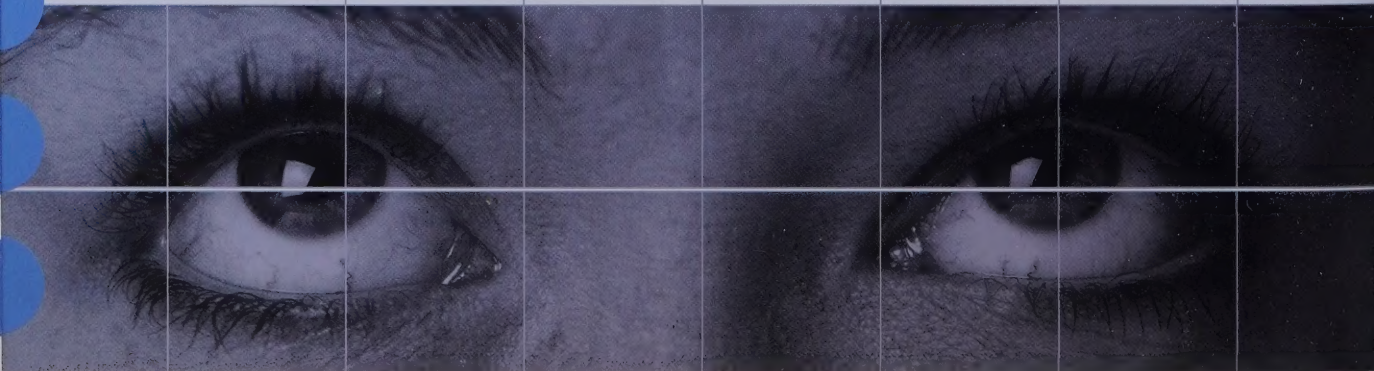
— FIRST AMERICAN HEALTH INC.

"TUNEBUILDER HAS SAVED ME HOURS OF EDITING TIME

— TANDEM TELEVISION NETWORK

"AT 21ST CENTURY VIDEO PRODUCTIONS, WE APPLY CUTTING EDGE TECHNOLOGY TO EVERY AREA OF OUR BUSINESS. ONE OF THE MOST IMPRESSIVE PIECES OF OUR ARSENAL IS THE TUNEBUILDER SOFTWARE. THERE'S NEVER A NEED TO WORRY ABOUT THE MUSIC WHEN TUNEBUILDER IS ON THE JOB!"

— 21ST CENTURY VIDEO PRODUCTIONS



Letter to Shareholders

WE ARE

proud to report

that this past year was a year of great progress for AirWorks. During the course of the year, we acquired the assets of Syndavier (SOC) and successfully integrated their software code and product line, continued development on several market-leading products, established exciting new strategic and OEM alliances, and our products received some of the industry's most coveted awards for excellence. Through our commitment to creating and supporting market-leading products, we are able to take maximum advantage of the opportunities awaiting us.

AirWorks occupies an important position in the future of sound in the computer.

THE MISSION of

AirWorks is to assist people to easily use sound and music as they explore the world of the computer as life-tool. AirWorks wants to be the de facto software standard for automatically handling the tasks of music, sound and audio workflow.

THE CORE BUSINESS

of AirWorks is to develop, publish and manufacture software for sound and

music task handling and databasing. The markets for AirWorks' products are: multimedia, music publishing, music recording, broadcast, presentation, education, and film/video post-production.

OUR GOAL is to become the leading, worldwide supplier of products and services relating to the use of intelligent creativity enhancers and tools for music by the year 2000. We recognize that this can only be achieved at AirWorks if our products enable our customers to be more creative in meeting their business and personal needs. Consequently, we will continue to position AirWorks for growth by enhancing our products and services in a timely fashion, and by continuing to expand our market position.

The astonishing growth in the use of sound and music for business and personal applications is largely attributable to the ability of the computer to supply many creative tools to the ordinary user that were previously only available to professional users. As organizations and individuals become comfortable using computers to enhance their daily lives and business communications, they are increasingly seeing the value of harnessing music and sound in new and innovative places. The use of music and sound to assist in creating a new, positive experience for the viewer of the computer screen is increasing at a very fast rate. It is expected that the use of music and sound in computers will become pervasive as people either achieve a threshold of knowledge regarding sound and music, or become more adept at using tools that enhance their creativity as never before. The combined sound and music markets consist of people who use music and sound in their everyday work—the media, film and video production, advertising, education, entertainment and games—plus a new and exciting category that has the promise of being the single largest market—the mass market segment. The mass market user group is a large category, and growing everyday due to the development of tools that allow anyone to enjoy using music and sound as an accompaniment to home movies, family projects and hobbies created on the computer. The overall market for sound tools in the computer is expected to grow rapidly, creating associated market revenues of approximately \$500 million US by 1998, as estimated by our management from close industry observation. AirWorks, with its tools specifically designed for accessibility by those with beginner-level skill, knowledge and experience, expects to garner a significant percentage of this market.

It is no surprise that when sound and music are used to enhance communication,

**THE TOOLS ARE
FUNDAMENTALLY
IMPORTANT.**

As organizations and individuals can turn to AirWorks for the complete range of tools they need to find, audition, notate, edit, and produce their communications, AirWorks is uniquely in a position to take advantage of the resulting market opportunities. Tools for enhancing personal and business projects, such as TuneBuilder, TuneFinder and S/Link, round out our exceptional product suite.

Our library partners and their customers have always been our most important partners, and 1996 saw us continuing to harness their existing distribution channels throughout the United States and Europe. This has enabled us to expand our market presence and our products and services are now poised to reach a world wide audience.

Today, consumers will find TuneBuilder through their music supplier, production music libraries, and through a selection of strategic partnerships with companies involved in video and Internet software. Soon, as the new computer owner explores their system, they will see AirWorks tools already loaded in the software and hardware.

An assessment of our strategies during fiscal 1996 demonstrates that we continued to lay cornerstones for future growth. Although still in a pre-revenue position, the Company acquired key assets to maintain and increase the potential to achieve our goal. Our change in status over the last year is a credit to the innovation, determination and dedication of our employees. It is their energy and spirit that provide us with a strong competitive advantage.

In Fiscal 1996, the activity of software development was moved into the Company operations, and the entire year was dedicated to integrating the new SOC-acquired code and to revisiting the development of every program undertaken by the Company since its inception. This allowed management to underpin the operations with a very stable code base, and to create a technology strategy that would allow rapid development of innumerable niche products.

Throughout 1996, AirWorks' products and services continued to win market acceptance and industry accolades. TuneBuilder self-editing music software received a Cool Stuff Award at the 1996 National Association of Broadcasters trade show in Las Vegas, and was rated as being one of the top two multimedia products shown at COMDEX '95 by Digital Media Associates' Matrix Magazine. These awards come with high-profile exposure which we have used extensively in our sales, marketing, advertising and product packaging endeavors. Winning these awards tremendously increases our market exposure, as a large number of users rely on these to guide their purchasing decisions, and to keep them informed about

A VAST AND FAST- MOVING INDUSTRY.

The strategic importance of the Synclavier® asset purchase became obvious in 1996. The industry began to accept AirWorks and its product offering, enabling AirWorks to enjoy the continuing reputation earned by Synclavier in the mid '80s as a desktop audio pioneer. Coupled with the power of TuneBuilder, this was instrumental in positioning AirWorks as a leading contender, even while still developing its full product line.

To increase the penetration of our products internationally, we began an American marketing operation, and established facilities in New England to begin the integration of the AirWorks and Synclavier software. This was the predominant activity of 1996, and as the year ended we announced the development of SoundHouse, the world's first integrated sound task handling suite, a "Microsoft Office" for music and sound, as it were. This focus of establishing multiple products for the music user in diverse marketplaces will enable us to tap into rapidly growing global opportunities.

I am also pleased to report that during the first months of 1997, we entered an agreement with North Star Capital Management of Stamford, CT, to assist in obtaining funding. The purpose of this funding will be to launch our innovative and unique product line to the market, and to attain a pre-eminent position as the world's only sound suite.

This past fiscal year was a rewarding one for AirWorks. I wish to thank our strategic partners, OEM partners, our library partners and their customers for their continued commitment to our products and services, our shareholders for their confidence, and our employees for their extraordinary energy, dedication and effort. AirWorks has the right products and the right people, readily able to generate strong and sustainable growth in a rapidly evolving market. We look forward with confidence to the many challenges and opportunities that 1997 will deliver.



Darryl A. Goede
Chairman and CEO

A Technology Platform for the Future

The Company has always adhered to the conviction that music and sound applications for business and personal use are best handled by software applications. Though we had the required expertise relating to music, sound control and data management, acquiring technology was critical. We attained that technology by acquiring the assets of SOC, the developer of the Synclavier, a powerful sound and music task management system.

This gave us a combination of technologies which will admit us as leaders in the field of automated music and sound handling in the computer. These emerging market opportunities are not currently being served in the marketplace, and can not easily be replicated by others without the resources and deep understanding of music and sound application and software technologies that we now have.

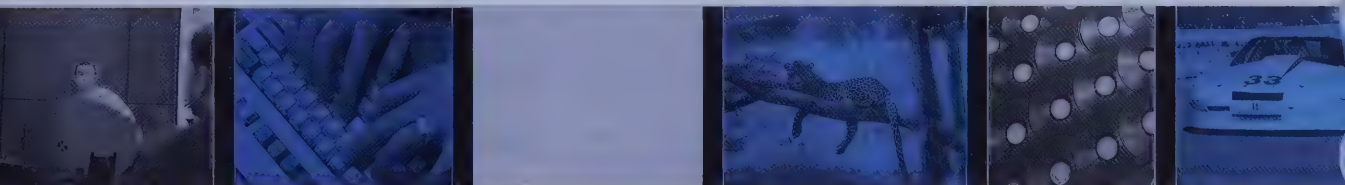
Product development and enhancement is a crucial component of our future plans. To this end, a sizable investment has been committed in research and development to improve and update our current products, as well as develop future new programs.

In the area of automatic music handling, we

developed TuneBuilder 2.0 for Windows 95, an automatic music editor which will be completed in early 1997. We also developed TuneFinder, a stand-alone music information database search and audition system, and completed S/Link, a comprehensive sound file transfer and formatting utility.

On the music environment side, the Company developed SoundHouse, the world's first music handling suite (previously known as "Tapestry.") Using the technologies acquired in the SOC acquisition, we have created a common framework for working with music and sound at all levels from neophyte to professional. Using the rescaling abilities of Object Oriented Design, SoundHouse is an integrated task management environment containing all AirWorks applications, and able to handle diverse needs for content, tools and work flow.

This aggressive development program will allow us to keep our competitive advantage and will prepare us to keep our customers satisfied and loyal. A significant part of future business will include Internet commerce and data management. We will be ready to capitalize on that future.



Growing our Client Base

The most important goal of our marketing is to capitalize on the unique ability of AirWorks products to bring the satisfaction, enjoyment and power of music and sound to the ordinary user. This group constitutes a very large and hitherto untapped marketplace for us, and we are focused on achieving a swift penetration and consolidation of this mass market. Our strategy to build our client base has been successful. By targeting and acquiring production music libraries as our distribution partners, we have been able to gain access to large existing client bases, and form important strategic relationships. These new clients are offered

software-based products to automatically achieve results on standard industry tasks. Conversely, we are also able to parallel-market other products to the same client base. Significantly more cost effective than marketing to new clients on a one-at-a-time basis, marketing to large client groups is based on developing software applications with wide usage and broad appeal.

Further, our Company has now moved into strategic OEM alliances with industry leaders to access their existing and developing client bases over a sweeping cross-section of industries.

Sales and Marketing Strategy

The market for AirWorks is defined as those who use music and sound as a component of production and as a raw material in their products. This incorporates, in order of size from large to small: casual and hobby users, multimedia developers, video and filmed entertainment producers, professional presenters, music publishers, and music producers. We have ranked our priority in a likewise fashion.

AirWorks has placed a strategic importance on accessing its markets through existing distribution channels, commencing business by developing product distribution relationships with production music library businesses, and further, with strategic OEM partners.

The Internet will be used extensively. AirWorks'

products are completely digital in nature, allowing the Company to take advantage of the capabilities of the Internet to be used for promotion, sales, distribution and customer support.

AirWorks owns the world's foremost sound sample library, presently distributed by Ilio Entertainments Inc. through a retail distribution network. This sets the stage for enabling the Company to promote its other products cost effectively in the retail arena.

Through existing strategic OEM alliances, the Company will access approximately 2.5 million qualified potential users. OEM, bundling and software development kit strategies will continue as a main activity for sales and marketing as the products are launched.



Strategic Alliances

In 1996, relationships continued to be forged with leading production music libraries throughout the US and Europe:

MATCH MUSIC:

Match Music, a major London-based music library serving broadcasters, film, television and commercial production customers throughout the United Kingdom and Europe, became the 15th major music library in the world to adopt AirWorks' revolutionary TuneBuilder automatic music editing software technology for use with its entire library of music CDs.

PROMUSIC:

One of the largest production music libraries in North America, ProMusic is American-based with 28 separate title collections.

Foundation work continued throughout 1996 on key strategic alliances culminated in 1997:

STRATA:

Integration of TuneBuilder into the Mac and Windows version of VideoShop, the most widely distributed video software program. Programs also bundled for delivery are S/Link and TuneFinder.

ROLAND:

AirWorks will provide an integrated software application for Roland's Digital Audio Editor utilizing AutoConform and EditView.

DIGERATI:

Integration of TuneBuilder with MovieClips Software, to be internationally distributed in bundle packages with industry-leading products.



Applications

TUNE BUILDER

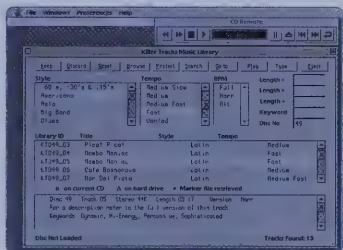
A powerful automatic music editing system with over 14,000 music selections presently TuneBuilder-enabled. Enables the user to instantly adapt music to any individual purpose; changing length, rearranging internal order of music selections, creating automatic endings, and customizing music to exactly fit the action in video and film.

TUNE FINDER

A real-time search and audition program that supports independent music information or the libraries of the AirWorks library partners. Allows the user to create and manage project lists for selection and placement of music into creative projects.

SOUNDHOUSE

A fully integrated music handling suite that is rescalable to the needs of the individual hobbyist and the professional user. Includes automatic editing, auditioning, location, project management and file format translation.



S/LINK

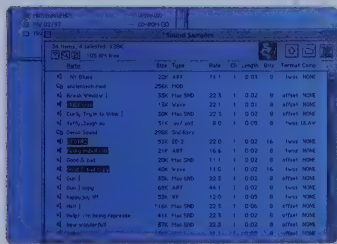
A full-featured sound file transfer and conversion program for multimedia authors, sound designers, broadcasters, music producers, post-production and corporate presenters to transfer digital audio easily and quickly from system to system. S/Link features: multiple destination, file re-format, unattended batch conversions, instant audition, on-the-fly variable sample rate and sample width conversions.

AUTOCONFORM

AutoConform automates the editing and synchronizing of audio to picture. Converts industry standard Edit Decision Lists (EDLs) into common format, then uses the EDL to control external machines to automatically retrieve and load source material... unattended... into your Digital Audio Workstation. AutoConform features source audio recording, status indication, head/tail trimming, source splitting,

EDITVIEW

EditView is a baseline sound editor graphic user interface. Allows out of sequence editing and has easy-to-use drag-and-drop features. Allows audio sequencing, event duration and position.



Management Team

- Darryl Goede: CEO, President, Chairman of the Board
- Griffith McRee: Senior VP, COO
- Nancy Goede: VP, Corporate Affairs
- Harland Kirby: VP, Sales
- Richard Ploss: Director of Software Development
- Blake Fallis: Manager, Investor Relations

* TuneBuilder, S/Link and Synclavier are registered trademarks, and TuneFinder, AutoConform, EditView and SoundHouse are trademarks of AirWorks. All other tradenames and trademarks used in this document are the property of their respective owners, and are used in reference only. All rights reserved.

Management's Discussion and Analysis

of consolidated financial condition and results of operations of Fiscal Year Ended December 31, 1996

The following discussion should be read in conjunction with, and is qualified in its entirety by the Consolidated Financial Statements and related notes included elsewhere herein. Historical results of operations,

percentage relationships and any trends that may be inferred therefrom are not necessarily indicative of the operating results for any future period. All amounts are in Canadian dollars unless otherwise stated.

Overview

AirWorks Media Inc. is an Alberta-based public Company whose shares trade on the Alberta Stock Exchange under the symbol AWM:ASE. The Company is a reporting issuer to the Alberta Stock Exchange, and lists its shares on the OTC bulletin board under the symbol AWM-SF.

Operations

Revenue

Revenue of AirWorks is derived from the following:

- Proceeds from sale of software and instruction files. Revenue is recognized upon delivery.
- Royalties from license of Synclavier sample library. Revenue is earned pursuant to a licensing agreement with Illo Entertainments Inc. and is recognized upon receipt.

Direct Costs

Direct costs as a percentage of revenue decreased from 29% in the year ended December 31, 1995 to 22% in the year ended December 31, 1996. Direct costs consist of cost of goods sold and distribution royalties. Sales mix affects cost, since certain sales require the shipment of prepackaged disks and documentation, others require either minimal disks and documentation, or the customer is responsible for all reproduction expenses.

In future periods, management expects that gross margins as a percentage of net sales will continue to be impacted by the sales mix. Management continues to take steps to improve gross margins.

Advertising, Marketing and Communications

Advertising, marketing and communications expenses increased from \$79,977 in the year ended December 31, 1995 to \$1,266,700 in the year ended December 31, 1996, an increase of \$1,186,723 or 1,484%, as these costs were capitalized in 1995. Advertising, marketing and communications expenses consist of salaries, commissions and related expenses of sales and marketing personnel and outside marketing and promotional expenses. The expenses in 1996 resulted primarily from expanding the Company's participation in international trade shows in order to promote future sales of its TuneBuilder and SoundHouse products. The increase in 1996 was also due to Company and product advertising costs incurred in various industry publications, and to announce the acquisition of Synclavier. A number of additional employees were hired in marketing and inside sales, while the number of employees involved in direct training was reduced. The Company expects to continue to hire additional sales and marketing personnel.

General and Administrative

General and administrative expenses increased from \$171,326 in the year ended December 31, 1995 to \$361,466 in the year ended December 31, 1996, an increase of \$190,140 or 111%. General and administrative expenses include salaries and employee benefits, facility costs, professional fees and related overhead costs. The increase in 1996 is primarily due to the hiring of additional administrative employees to support the company's activities in commercializing its technology.

The head office of the Company is located in Edmonton, Alberta, Canada, and as at December 31, 1996, had thirty-four personnel, consisting of nine software engineers and project management, fourteen music analysts, two in fulfillment, six in administration, one in investor relations, and four in marketing.

Research & Development

AirWorks' technology strategy is to adapt its existing and acquired software into a flexible suite of products able to be made into "toolkits" for many niche markets. Additionally, the Company has focused attention to developing different levels of its sound handling environments for increased mass market penetration.

Research and development expenses in the year ended December 31, 1996 were \$2,052,496. Research and development expenses were capitalized in 1995. Research and development expenses consist primarily of personnel and equipment costs required to conduct the Company's research and development efforts, including project engineers, product documentation, technical support, internal testing and development, and standards and quality assurance. The increase in expenses over the prior period was due primarily to increased staffing and associated costs required to enhance, support and expand the Company's product offerings resulting from the purchase of Synclavier and the integration of AirWorks' existing products to those acquired in the purchase.

Long-term Receivables

Long-term receivables consist of balances due from music libraries for their portion of encoding costs under an agreement to share revenue derived from TuneBuilder-based products. The products are sold to their customers. Under the agreement, the library pays its portion of encoding costs upon generating sales revenue. In 1996, the Company altered its agreement, and now retains all revenues from sales of TuneBuilder-based technology, less a royalty paid to the library per instruction file sold. As a result, the Company has reversed the long-term receivables and written them down.

Change in Accounting Policy Relating to Software Technology

During the year ended December 31, 1996, the Company reassessed the carrying value of the development costs previously deferred on its software products, elected to expense all costs of software development incurred in the year, and recorded a full write-down of all prior development costs previously capitalized.

The prior treatment was to capitalize all software development and related costs and then to amortize the asset over the expected life of the core technology without change.

In 1996, the Company commissioned KPMG to review the Company's financial statements to determine if the statements complied with US generally accepted accounting principles (GAAP). The commission was part of the process undertaken by the Company to prepare an application to offer its securities over-the-counter to the American market. KPMG confirmed that AirWorks financial statements complied with

US GAAP. However, the review demonstrated to the Company that the practice of US software development companies is to expense all software development costs in the same period as incurred. Therefore, the Company decided to restate its capitalized development costs with respect to software industry standards as a major part of standardizing the company's cost accounting for products primarily marketed in the US. The decision to state development costs in a more conservative fashion will also assist as the Company prepares to enter the American markets for its securities.

Liquidity and Capital Resources

To date, the Company has funded its operations primarily through the private and public sale of equity securities, and to a lesser extent, through long-term debt and bank indebtedness. The Company has

credit facilities secured by corporate assets with a Canadian credit union in the amount of \$25,000. The credit facilities, renewed annually, are for operating purposes, along with a small amount of foreign exchange hedging activities. At December 31, 1996 the Company had \$77,708 in cash.

Subsequent to the year end, the Company entered discussions regarding the development of an offering of securities in the US. The Company believes that the net proceeds from this offering, if undertaken, together with existing sources of liquidity and cash generated from operations, will be sufficient to meet its capital expenditures, working capital and other cash requirements over the next 18 months. Depending on the Company's future growth and acquisitions, if any, it may become necessary to secure additional sources of financing.

Financial Conditions and Operating Highlights

Cash

Cash and short term investments increased by \$72,606, due to improved cash management. Cash surplus to operational requirements was invested in an interest-bearing account.

Capital Assets

Capital assets increased \$97,730 during the year from \$277,981 to \$375,711, on the basis of net book value. Of this amount, most was an increase in capital leases of computer equipment, office equipment, and computer software. These purchases were required to replace and upgrade past generation systems and to outfit new employees hired during the year.

Long Term Debt

A significant increase in long term debt occurred primarily as a result of the Company's agreement with BayBank to acquire the assets of SOC, whereby the Company assumed a debt of \$142,000 US by way of a note payable secured on equipment, as detailed in Note 9 to the financial statements.

Accrued Liability

After initially accepting agreements in 1994 held by the Company with its independent contractors, Revenue Canada re-classified these agreements as employee contracts, and assessed the Company \$156,352, creating a retroactive claim of unremitted source deductions for 1994 and 1995. Of this claim, \$40,000 has been advanced under protest to Revenue

Canada, and a further \$80,000 has been set aside by the Company as a legal and contingency fund. Nevertheless, provision for \$93,285 has been made for the portion of this liability related to the Company's withholdings. Management is aggressively appealing the assessment. Subsequent to year end, the Company arranged private financing of \$350,000 for the purpose of funding accrued liabilities and related expenses, should the appeal not be successful.

The Company has successfully defended itself against alleged damages of \$1.6 million in a law suit totalling \$1.75 million. An amount of \$157,917 CDN has been accrued in the financial statements pursuant to a jury award made by a US court of law. The Company subsequently appealed the decision and on June 10, 1997, the judge completely reversed the award, leaving \$7,000 US in undisputed expenses.

Share Capital

Share capital increased by \$3,358,821 during the year due to the issuance of 2,500,175 shares. Additionally, stock options were granted to employees, contractors, officers and directors, as detailed in Note 11 of the financial statements.

The shares and options were issued throughout the year pursuant to agreements with to employees, contractors, officers and directors. The Company issued shares to raise capital in connection with its requirements for additional capital to purchase SOC, and to complete its research and development.

Outlook

Fiscal 1996 was challenging, both in its significant growth and in its renewed attention to integrating a solid foundation technology for accelerated software development systems. The Company remained focused on integrating new software technologies acquired in the SOC acquisition, initiating sales and marketing programs, increasing its client base, integrating its operations, and developing strategic alliances. This focus resulted in foregoing profitable operations in fiscal 1996, in exchange for future gain and profitability.

As a direct result, AirWorks is no longer a one-product company, and has systematically developed an entire palette of software products for the sound and music user. SoundHouse, the first version of the Company's new integrated sound toolkit, is scheduled for completion in the second quarter of 1997, and includes GUI (graphic user interface) version upgrades of its programs offering enhanced automated solutions targeted at new and larger customer bases.

The Company's access to the client bases of its strategic alliance partners now exceeds 2.5 million potential customers, from which significant future revenues are expected. Management believes that demand for the Company's products within this customer base is

inevitable, given that a software application solution is significantly more economical and efficient for the customer than continued use of existing hardware-based technology. This is especially true of complex applications like creative products and core sound handling systems.

The Company intends to continue with its strategy of pursuing opportunities where it can sell its new products in high volumes to large customer bases, including further acquisitions, strategic alliances, OEM alliances, and private labeling of its products for sale by other organizations.

Advertising and public relations have raised general awareness of the Company and its products, as evidenced by more than 100 product reviews, articles and announcements which have been published, commencing the first quarter of fiscal 1996. Sales and marketing programs, and strategic alliances initiated in fiscal 1996 are expected to positively impact the Company's revenues in fiscal 1997.

Management's Responsibility for Financial Reporting

Management is responsible for the preparation of the Consolidated Financial Statements and other financial information. The financial statements are prepared on a historical cost basis and in accordance with the Canadian generally accepted accounting principles. The financial statements and financial information include amounts that are estimates based on the best judgment of the Company's management and of the management of significant operating subsidiaries. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects.

The Company maintains systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is relevant, reasonable and accurate, and that the Company's assets are appropriately accounted for and adequately safeguarded. The systems are designed and operated under the supervision of the management of the Company.

Corporate Governance

The Company's Board of Directors is presently comprised of four members - the President and Chief Executive Officer, and three outside directors. The Board has plenary powers. Responsibilities not delegated

to the senior management or to a committee of the Board remain those of the full Board.

Addition of three members during the next year is contemplated, in order to attain a wider spectrum of specific industry expertise, particularly relating to American securities issues and marketing of creative products.

The Board of Directors carries out its responsibility for the financial reporting in this Annual Report principally through its Audit Committee which is composed of a majority of directors who are not officers or employees of the Company. The Audit Committee of the Company is composed of three outside directors and meets as required with management and independent auditors to review the Company's audited financial statements and to monitor accounting policies. The independent auditors, Gardiner Karbani Audy & Partners, are appointed by the shareholders to conduct an independent examination in accordance with generally accepted auditing standards and express their opinion on the Consolidated Financial Statements. The shareholders' auditors have full access to the Audit Committee.

The Compensation Committee is comprised of the President and CEO, and three outside directors. Its function is to review and recommend to the Board on matters relating to compensation of key management personnel and the granting of share purchase options to employees, directors and consultants.



Consolidated Financial Statements

Auditor's Report

To the Shareholders of AirWorks Media Incorporated:

We have audited the consolidated balance sheet of AirWorks Media Incorporated as at December 31, 1996 and the consolidated statements of deficit, income and changes in financial position for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

May 9, 1997
Edmonton, Alberta

Gardiner Karbani Audy + Partners



Chartered Accountants
Edmonton, Alberta

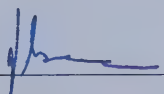
Financial Statements

Consolidated Balance Sheet

As at December 31, 1996

ASSETS	1996 (\$)	1995 (\$)
Current assets:		
Cash	77,708	5,102
Accounts receivable	41,776	104,102
Inventories	227,328	247,408
Prepaid expenses	108,175	22,804
Total current assets	454,987	379,416
Long-term receivables, Note 2	—	463,223
Capital assets, Note 3	375,711	277,981
Music catalogue, Note 4	63,908	82,979
Software technology, Note 5	—	3,147,091
	<u>894,606</u>	<u>4,350,690</u>
LIABILITIES		
Current liabilities:		
Accounts payable	541,051	236,923
Accrued liabilities, Note 6	251,202	—
Loan payable, Note 7	33,898	—
Current portion of long-term debt	98,650	14,600
Current portion of obligation under capital leases	63,579	36,340
Total current liabilities	988,380	287,863
Share subscriptions received in advance, Note 8	1,227,700	1,247,664
Long-term debt, Note 9	71,278	6,250
Obligation under capital leases, Note 10	78,774	61,790
Total liabilities	<u>2,366,132</u>	<u>1,603,567</u>
SHAREHOLDERS' EQUITY (DEFICIT)		
Share capital, Note 11	6,197,274	2,838,453
Deficit	(7,668,800)	(91,330)
Total shareholders' equity	<u>(1,471,526)</u>	<u>2,747,123</u>
	<u>894,606</u>	<u>4,350,690</u>

SIGNED ON BEHALF OF THE BOARD:

Director 

Director 

Financial Statements

Consolidated Statement of Deficit

For the Year Ended December 31, 1996

	1996 (\$)	1995 (\$)
Balance, beginning of year	(91,330)	(108,899)
Net income (loss)	<u>(7,577,470)</u>	<u>17,569</u>
Balance, end of year	<u><u>(7,668,800)</u></u>	<u><u>(91,330)</u></u>

The accompanying notes are an integral part of these financial statements.

Financial Statements

Consolidated Statement of Income

For the Year Ended December 31, 1996

	1996 (\$)	1995 (\$)
Revenue:		
Encoding	252,616	453,572
Licensing royalties	74,093	—
Arpeggio sales	30,535	59,142
Video and graphics	7,435	6,298
	<u>364,679</u>	<u>519,012</u>
Direct Costs:		
Cost of goods sold	21,721	68,937
Distribution royalties, Note 12	57,931	83,246
	<u>79,652</u>	<u>152,183</u>
Income after direct costs	<u>285,027</u>	<u>366,829</u>
Indirect Costs:		
Advertising, marketing and communications	1,266,700	79,977
Bank interest and service charges	11,094	11,637
Equipment rental and maintenance	5,439	7,144
Insurance	19,129	11,247
Interest on long-term debt	21,642	3,242
Office rent	22,393	24,696
Office supplies	18,852	15,845
Professional fees	85,240	35,812
Telephone and utilities	16,454	11,015
Travel	28,515	15,118
Wages	132,708	35,570
	<u>1,628,166</u>	<u>251,303</u>
Income (loss) before the following	<u>(1,343,139)</u>	<u>115,526</u>
Other Expenses (Income):		
Amortization	134,332	65,041
Litigation award, Note 6	157,917	—
Loss (gain) on disposal of capital assets	(819)	10,339
Software development	2,052,496	—
Write down of long-term receivables, Note 2	743,314	22,577
Write down of software technology, Note 5	3,147,091	—
	<u>6,234,331</u>	<u>97,957</u>
Net income (loss)	<u>(7,577,470)</u>	<u>17,569</u>
Earnings (loss) per share	<u>\$ (0.7263)</u>	<u>\$ 0.0023</u>

The accompanying notes are an integral part of these financial statements.

Financial Statements

Consolidated Statement of Changes in Financial Position

For the Year Ended December 31, 1996

	1996 (\$)	1995 (\$)
CASH PROVIDED FROM (USED IN):		
OPERATING ACTIVITIES:		
Net income (loss)	(7,577,470)	17,569
Items not affecting cash:		
Amortization	134,332	65,041
Loss (gain) on disposal of capital assets	(819)	10,339
Write down of software technology	3,147,091	—
	(4,296,866)	92,949
Changes to non-cash operating assets and liabilities:		
Accounts receivable	62,772	52,996
Inventories	20,080	(55,373)
Prepaid expenses	(85,371)	(18,674)
Accounts payable	304,128	52,686
Accrued liabilities	251,202	—
Loan payable	33,898	(110,327)
	(3,710,157)	14,257
FINANCING ACTIVITIES:		
Long-term receivables	463,223	(349,287)
Share subscriptions received in advance	(19,964)	1,247,664
Issuance of long-term debt	191,000	—
Payments on long-term debt	(41,922)	(12,600)
Issuance of obligation under capital leases	96,948	80,198
Payments on obligation under capital leases	(52,725)	(21,455)
Issuance of share capital	3,358,821	750,501
	3,995,381	1,695,021
INVESTMENT ACTIVITIES:		
Proceeds on disposal of capital assets	5,608	13,117
Purchase of capital assets	(218,226)	(147,809)
Enhancements to software technology	—	(1,565,739)
	(212,618)	(1,700,431)
INCREASE TO CASH	72,606	8,847
CASH (BANK INDEBTEDNESS), BEGINNING OF YEAR	5,102	(3,745)
CASH, END OF YEAR	77,708	5,102

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

For the Year Ended December 31, 1996

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Operations:

The Company develops, markets and licenses music editing software products.

These financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its obligations in the normal course of operations.

Continuing operations are dependent upon the Company being able to raise new capital and its ability to achieve a commercial level of production and sales for its products. If the going concern assumption were not appropriate for these financial statements, then adjustments to the carrying values of the Company's assets might be necessary.

(b) Basis of Consolidation:

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, AirWorks Corporation.

(c) Foreign Currency Translation:

The monetary assets and liabilities of AirWorks Corporation have been translated upon consolidation at current rates, revenue and expense items at average rates for the year and non-monetary items at historical rates. Translation gains or losses are included in the determination of operating results.

(d) Inventories:

Inventories are valued at the lower of cost and net realizable value.

(e) Capital Assets and Amortization:

Capital assets are recorded at cost which does not necessarily represent fair market value.

Amortization is recorded at the following annual rates without residual values:

Furniture and equipment	20%	declining balance
Camera equipment	20%	declining balance
Computer equipment	30%	declining balance
Software	50%	declining balance
Leasehold improvements	10%	straight-line

In the year of acquisition, amortization is calculated at one-half of the annual rates.

(f) Music Catalogue:

Music catalogue consists of a licensing agreement and catalogue enhancement costs which are recorded at cost and amortized on a straight-line basis over ten years, without residual value.

(g) Software Technology:

Prior to 1996, software development costs which met specific criteria related to technical, market and financial feasibility were capitalized as software technology. Amortization was recorded upon commencement of commercial production as follows:

- 5% straight line on each specific instruction file, without residual value.

- ratio of actual units of TuneBuilder sold to estimated units to be sold over a ten year period.

The carrying value of software technology was assessed by analyzing revenue and the continuing development costs required to maintain the software.

In 1996, all costs of software development incurred in the year were fully expensed and a full write down of software technology capitalized to December 31, 1995 was recorded to reflect the Company's decision to restate its capitalized development costs as a major part of standardizing the Company's accounting for products in the software technology industry.

(h) Revenue:

Licensing royalties are earned pursuant to a licensing agreement and are recognized upon receipt.

Revenue from the distribution of the Arpeggio music is recorded as each copy of the library is delivered and billed.

2. LONG-TERM RECEIVABLES:

Long-term receivables consist of balances due from music libraries for encoding services provided. In 1996, the Company renegotiated the terms with the music libraries whereby the Company would retain revenues from sales, less commissions. A write down of long-term receivables has been recorded to reflect the change in the nature of the agreement and possible delays in collection. Any subsequent collections will be recorded in the year collected.

	1996 (\$)	1995 (\$)
Long-term receivables	743,314	463,223
Write-down of long-term receivables	(743,314)	—
	<u>—</u>	<u>463,223</u>

3. CAPITAL ASSETS AND ACCUMULATED AMORTIZATION:

	1996 (\$)		1995 (\$)	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Furniture and equipment	282,132	106,260	175,872	118,765
Camera equipment	14,850	11,824	3,026	3,932
Computer equipment	336,444	161,432	175,012	143,568
Software	51,829	33,731	18,098	7,725
Leasehold improvements	6,061	2,358	3,703	3,991
	<u>691,316</u>	<u>315,605</u>	<u>375,711</u>	<u>277,981</u>

4. MUSIC CATALOGUE:

	1996 (\$)	1995 (\$)
Licensing agreement	100,000	100,000
Catalogue enhancement costs	<u>90,711</u>	<u>90,711</u>
	190,711	190,711
Accumulated amortization	<u>(126,803)</u>	<u>(107,732)</u>
	<u>63,908</u>	<u>82,979</u>

5. SOFTWARE TECHNOLOGY:

	1996 (\$)	1995 (\$)
Software technology, at cost	3,159,041	3,159,041
Accumulated amortization	(11,950)	(11,950)
Write down of software technology	(3,147,091)	—
	<u>—</u>	<u>3,147,091</u>

In 1996, a write down of software technology capitalized to December 31, 1995, was recorded to reflect the Company's decision to restate its capitalized development costs as a major part of standardizing the Company's accounting for products in the software technology industry.

6. ACCRUED LIABILITIES:

	1996 (\$)	1995 (\$)
Payroll accrual	93,285	—
Litigation award	157,917	—
	<u>251,202</u>	<u>—</u>

Both the above amounts, accrued as liabilities, are being appealed by the Company.

The payroll accrual arises from a ruling by Revenue Canada that certain sub-contractors are employees for income tax purposes, resulting in an assessment of unremitted source deductions and interest.

The litigation award relates to an award by a United States District Court in April, 1997 for damages for alleged breach of contract.

Subsequent to year end, the Company has arranged financing of approximately \$350,000 (including \$250,000 from officers of the Company) for the purpose of funding these accrued liabilities and associated costs, should the appeals not be successful.

7. LOAN PAYABLE:

Loan payable is unsecured, without specified terms of repayment and bears interest at 12% per annum. The balance is due on demand and, consequently, has been classified as a current liability.

8. SHARE SUBSCRIPTIONS RECEIVED IN ADVANCE:

As at year-end, the directors approved the issuance of shares for private placements, the exercise of options and payment of obligations in lieu of cash as follows:

	1996 (\$)	1995 (\$)
(a) Deposits received on shares to be issued after year-end:		
• private placements	760,521	450,000
• options exercised	—	21,144
	<u>760,521</u>	<u>471,144</u>
(b) 12% convertible demand loan, convertible into common shares at a price of \$1.45 per share, converted on April 12, 1996	<u>—</u>	<u>100,000</u>
(c) Obligations to be settled by share issuance in lieu of cash payment:		
• officers	308,302	471,828
• employees	17,700	18,917
• suppliers	141,177	185,775
	<u>467,179</u>	<u>676,520</u>
	<u>1,227,700</u>	<u>1,247,664</u>

9. LONG-TERM DEBT:

	1996 (\$)	1995 (\$)
(a) Term bank loan, secured by equipment with a carrying value of \$23,146 and a general assignment of insurance, repayable in monthly instalments of \$1,050 to February, 1996 and \$1,250 thereafter plus interest at 11.5% per annum, with a maturity date of August, 1997	6,250	20,850
(b) Note payable, secured by equipment with a carrying value of \$326,925, repayable in monthly instalments of US \$5,500 plus interest at 9% per annum to February 28, 1997 and 12% thereafter, with a maturity date of September, 1998	163,678	—
	<u>169,928</u>	<u>20,850</u>
Deduct principal due within one year	98,650	14,600
Due beyond one year	<u>71,278</u>	<u>6,250</u>

Principal repayments of long-term debt over the next two years are as follows:

1997 (\$)	98,650
1998 (\$)	71,278
	<u>169,928</u>

10. OBLIGATION UNDER CAPITAL LEASES:

The following is a schedule of future minimum lease payments under capital leases expiring in 1999 together with the balance of the obligation under capital leases:

1997 (\$)	81,879
1998 (\$)	67,897
1999 (\$)	20,732
	<u>170,508</u>
Total minimum lease payments	170,508
Deduct: Amount representing interest ranging from 7% to 16% per annum	28,155
	<u>142,353</u>
Deduct principal due within one year	63,579
Due beyond one year	<u>78,774</u>

11. SHARE CAPITAL:

	1996 (\$)	1995 (\$)
Authorized:		
Unlimited number of non-voting redeemable, non-cumulative preferred shares issuable in series		
Unlimited number of voting common shares without nominal or par value		
Issued and Outstanding:		
10,433,582 common shares (1995 - 7,933,407)	6,197,274	2,838,453

Weighted average of shares outstanding in 1996 is 9,440,095 (1995 - 7,631,230).

During the year, the Company issued 2,500,175 common shares through private placement, issuance of shares for settlement of debt and options and warrants exercised for an aggregate of \$3,481,057 less costs of \$122,236 associated with the offerings.

The Company has reserved common shares under a director, management and employee option plan equal to 10% of the issued and outstanding shares. At December 31, 1996 there were 825,923 shares in director, management and employee stock options outstanding, as follows:

# of Shares	Exercise Price	Expiry Date
389,000	1.52	January 7, 1999
220,000	1.64	June 25, 2001
216,923	US 1.17	June 25, 2001
<u>825,923</u>		

At December 31, 1996 there were 472,917 warrants outstanding of which 125,000 are exercisable at \$2.35 per share and expire on March 1, 1998 and 347,917 are exercisable at \$2.25 per share and expire on August 31, 1997.

12. RELATED PARTY TRANSACTIONS:

- (a) During the year the Company entered into transactions with the following related parties:

98069 Alberta Ltd., a company controlled by the President of the Company.

Darryl Goede, President of the Company.

- (b) The particulars of these transactions are as follows:

	1996 (\$)	1995 (\$)
i) Royalty expense • 98069 Alberta Ltd.	13,437	15,621
• Darryl Goede	44,494	67,625
	<u>57,931</u>	<u>83,246</u>

The Company entered into a licensing agreement on February 1, 1988 with 98069 Alberta Ltd. which provides the Company with the right to distribute a catalogue of music images. The agreement provides for an 18% royalty to be paid on gross proceeds from Arpeggio music sales. In 1995, the licensing agreement was transferred to an unrelated Company and the original royalty agreement will expire when the existing inventory is sold. On May 1, 1994, the Company entered into an agreement with 98069 Alberta Ltd. to pay any future royalty obligations with shares in lieu of cash payment.

The Company entered into a licensing agreement on April 12, 1994 with Darryl Goede which provides the Company with the right to distribute TuneBuilder software. The agreement provides for an 18% royalty to be paid on gross proceeds from the sale of TuneBuilder and will expire when royalties in the cumulative amount of \$6,800,000 have been paid. On May 31, 1994, the Company entered into an agreement with Darryl Goede to pay any future royalty obligations with shares in lieu of cash payment.

These transactions are in the normal course of operations and are measured at the exchange amount, which is the consideration established and agreed to by the related parties.

13. LOSS CARRIED FORWARD:

The tax benefits pertaining to the loss carried forward for income tax

purposes have not been recognized in the financial statements. This loss carried forward, amounting to \$1,177,143, is available to be applied against future taxable income and expires as follows:

1997 (\$)	82,718
1998 (\$)	7,506
2000 (\$)	18,172
2002 (\$)	39,517
2003 (\$)	<u>1,029,230</u>
	<u>1,177,143</u>

In addition, timing differences of \$4,412,262 exist which, if recognized, would result in deferred income tax debits.

14. REMUNERATION OF OFFICERS:

Remuneration paid to the benefit of officers is \$257,822 (1995 - \$99,200).

15. OPERATING LEASES:

The Company has entered into agreements to lease equipment and real property for periods ranging from 36 to 60 months expiring in 2000. The future minimum lease payments are as follows:

1997 (\$)	87,371
1998 (\$)	32,753
1999 (\$)	33,683
2000 (\$)	<u>23,167</u>
	<u>176,974</u>

In addition to the above, the Company is also committed to pay its pro rata share of operating costs.

16. SUBSEQUENT EVENTS:

- (a) In April and May, 1997, the directors authorized the issuance of 1,222,575 shares in a private placement for total proceeds of \$1,619,000 of which \$700,000 was received at year end. Each share includes a share purchase warrant with an option to purchase one additional share per warrant as follows:

- 272,820 warrants exercisable at \$1.35 per share with an expiry date of April 18, 1999.
- 644,880 warrants exercisable at \$1.55 per share up to February 28, 1998 or \$1.75 up to February 28, 1999 at which time the warrants expire.
- 304,875 warrants exercisable at \$2.00 per share up to December 31, 1997 or \$2.40 per share up to December 31, 1998 at which time the warrants expire.

- (b) In April, 1997, 265,000 options were exercised at \$1.52 per share and an additional 257,000 options, exercisable at \$1.11 per share, were authorized.

- (c) In May, 1997, 75,000 shares were issued at \$1.11 per share in lieu of cash payment of obligations incurred after year end, at a total issuance price of \$83,250.

17. COMPARATIVE FIGURES:

Certain of the 1995 comparative figures have been reclassified to conform with the financial statement presentation adopted for 1996.

Corporate Directory and Shareholder Information

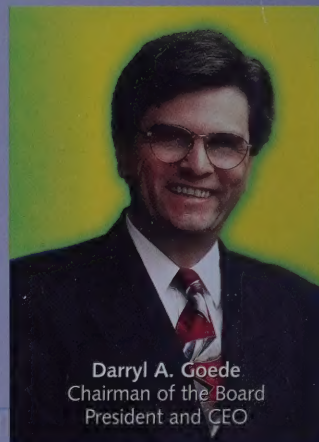
CORPORATE OFFICERS

Darryl A. Goede
President and CEO

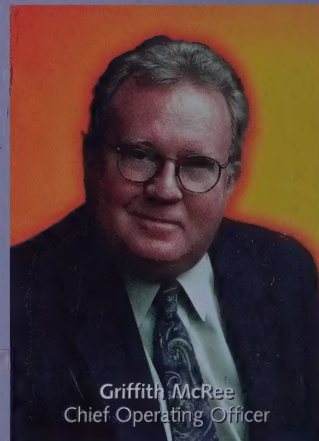
Griffith W. McRee
Chief Operating Officer

Nancy L. Goede
VP Corporate Affairs

Harland Kirby
VP Sales



Darryl A. Goede
Chairman of the Board
President and CEO



Griffith W. McRee
Chief Operating Officer



Nancy L. Goede
VP Corporate Affairs

BOARD OF DIRECTORS

Darryl A. Goede Dip. Mus.**
Chairman of the Board

Cheryl M. Knebel FCA* **
President and CEO, Cistrad Corporation

Robert Grandbois PEng.* **
Senior VP Sales, Visionwall Technologies Inc.

Kelly Palmer B.A., M.B.A., L.L.B.* **
Barrister & Solicitor

Secretary to The Board of Directors
Nancy L. Goede B.A.

*Member of the Audit Committee

**Member of the Compensation Committee

CORPORATE HEADQUARTERS

AirWorks Media Inc.
One Thornton Court, Suite 700
Edmonton Alberta T5J 2E7
Tel: (403) 424-9922
Fax: (403) 424-9993

LEGAL COUNSEL

Andrew J. Chamberlain
Edmonton, Canada
Arent Fox
Washington, DC

AUDITORS

Gardiner Karbani Audy & Partners
Edmonton, Canada

LEAD BANKERS

Bank of Nova Scotia
Edmonton, Canada

TRANSFER AGENT

Montreal Trust
Calgary, Canada

INVESTOR RELATIONS

Persons interested in being placed on the Company's mail list to receive information should direct inquiries to:

AirWorks Media Inc.
One Thornton Court, Suite 700
Edmonton Alberta Canada T5J 2E7
Tel: (403) 424-9922
Fax: (403) 424-9993
Website: <http://www.airworks.com>

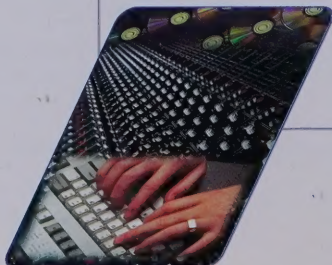
COMMON SHARES

The common shares of the Company are traded on the Alberta Stock Exchange (ASE), and are posted on the OTC Bulletin Board.

Annual Meeting of Shareholders

The annual meeting of shareholders will be held at:

The Centre Club Founders' Room
Edmonton AB Canada
on Tuesday, July 15 1997 at 2:00 pm.





No Boundaries.

WHAT DO YOU WANT TO HEAR NEXT?

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Poco 2.0 for Windows
AUTOConform 3.0
SLink 2.1
TUNE Finder 2.0
AirWaves
TUNE Builder 2.0
New Advisory group zeros in on important segments
You are faster





AIRWORKS